Republic of the Philippines
Department of Finance
Securities and Exchange Commission
SEC Bldg. EDSA, Greenhills, Mandaluyong City

OFFICE OF THE GENERAL COUNSEL

November 28, 2007

ATTY. ANDRE NAVATO JR.
Angara Abello Concepcion Regala & Cruz
ACCRA Building, 122 Gamboa St.
Legaspi Village, Makati City

OGC Opinion No. 07-21
For: Control Test Rule

Dear Atty. Navato Jr.:

We reply to your letter dated November 21, 2007 requesting opinion on behalf of your clients (collectively referred to as the "Members") Citadel Holdings, Inc. ("CHI"), Power Grid Corporation of India Ltd. ("PGI"), and Actis Infrastructure 2 LP ("Actis"), which have agreed to form a consortium that is participating in the 4th round of bidding for the Proposed Privatization by way of Concession of the Facilities and Assets of the National Transmission Corporation ("Proposed Privatization").

You alleged that the request is pursuant to the November 14, 2007 letter of the Power Sector Assets and Liabilities Management Corporation ("PSALM") requiring the Consortium to submit to it on or before November 29, 2007 an opinion from this Commission that the Consortium's proposed ownership structure and equity/investment in the corporation that will be formed to act as the Concessionaire and apply for a public utility franchise for the Proposed Privatization complies with the ownership requirements for grantees of a public utility franchise.

In your letter, you disclosed the following:

1. CHI, a corporation organized and existing under the laws of the Philippines, is 100% Filipino-owned;

2. PGI, a corporation organized and existing under the laws of India, is 100% foreign-owned;

3. Actis, a limited partnership organized and existing under the laws of the United Kingdom, is 100% foreign-owned;

4. From among the Members, only CHI and PGI have been pre-qualified by the PSALM to participate in the Proposed Privatization although the Members have a pending application with PSALM to include Actis as an additional member of the Consortium;

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5. The contemplated ownership structure and equity/investment of the Members for the Concessionaire is that such concessionaire shall be organized as a corporation under the laws of the Philippines and shall be wholly-owned by a holding company ("HoldCo") that will also be organized as a corporation under the laws of the Philippines by the Members of the Consortium;

6. On the assumption that PSALM approves the application of the Consortium to include Actis as an additional member thereof (Assumption A), the Members intend that their equity ownership in HoldCo shall be as follows:

   a. CHI - 60.5%
   b. PGI - 20%
   c. Actis - 19.5%

7. On the assumption that PSALM does not approve the application of the Consortium to include Actis as an additional member thereof (Assumption B), the Members intend that their equity ownership in HoldCo shall be as follows:

   a. CHI - 90%
   b. PGI - 10%

The ownership requirement for the grantees of a public utility franchise are provided in Section 11, Article XII of the Constitution which provides:

> "SECTION 11. No franchise, certificate, or any form of authorization for the operation of a public utility shall be granted except to citizens of the Philippines or to corporations or associations organized under the laws of the Philippines, at least sixty per centum of whose capital is owned by such citizens, x x x. The participation of foreign investors in the governing body of any public utility enterprise shall be limited to their proportionate share in its capital, and the executive and managing officers of such corporation or association must be citizens of the Philippines."

A Philippine national is defined by Section 3 of Republic Act 7042, as amended by Republic Act 8179, otherwise known as the "Foreign Investments Act of 1991" as:

> "...a citizen of the Philippines; or a domestic partnership or association wholly owned by citizens of the Philippines; or *a corporation organized under the laws of the Philippines of which at least sixty percent (60%) of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines*; or a corporation organized abroad and registered as doing business in the Philippines under the Corporation Code of which one hundred percent (100%) of the capital stock outstanding and entitled to vote is wholly owned by Filipinos or a trustee of funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine national and at least sixty percent (60%) of the fund will accrue to the benefit of Philippine nationals: Provided,

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That where a corporation and its non-Filipino stockholders own stocks in a Securities and Exchange Commission (SEC) registered enterprise, at least sixty percent (60%) of the capital stock outstanding and entitled to vote of both corporations must be owned and held by citizens of the Philippines and at least sixty percent (60%) of the members of the Board of Directors of of each of both corporations must be citizens of the Philippines, in order that the corporation shall be considered a Philippine national." (Italics supplied)

In your letter, you stated that either of the proposed structures of the Concessionaire complies with the ownership requirement for grantees of a public utility franchise as provided in Section 11, Article XII of the Constitution.

We confirm your position.

The cited provision of the Foreign Investments Act adopts the "control test" in determining the nationality of a corporation with foreign equity.[1] Under this test, "Shares belonging to corporations or partnerships at least 60% of the capital of which is owned by Filipino citizens shall be considered as of Philippine nationality, but if the percentage of Filipino ownership in the corporation or partnership is less than 60%, only the number of shares corresponding to such percentage shall be counted as of Philippine nationality..."[2]

Under Assumption A, the equity structure of the HoldCo shall be sixty and one-half percent (60.5%) Filipino-owned and thirty nine and one-half percent (39.5%) foreign-owned since CHI is one hundred percent (100%) owned by Philippine nationals. On the other hand, under Assumption B, the equity structure of the HoldCo shall be ninety percent (90%) Filipino-owned and ten percent (10%) foreign-owned.

Following the control test, the HoldCo, in both instances, shall be considered a Philippine national. Since the HoldCo shall wholly own the Concessionaire, the entire capital stock of the Concessionaire shall then be deemed Filipino-owned and in compliance with the requirements of the Constitution for grantees of a public utility franchise.

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1 Section 1(b) of the Amendments to the Implementing Rules and Regulations of R.A. 7042, as amended by R.A. 9179:

(b) Philippine National shall mean a citizen of the Philippines; or a domestic partnership or association wholly owned by citizens of the Philippines; or a corporation organized under the laws of the Philippines of which at least sixty percent (60%) of the capital stock outstanding and entitled to vote is owned and held by citizens of the Philippines; or a corporation organized abroad and registered as doing business in the Philippines under the Corporation Code of which one hundred percent (100%) of the capital stock outstanding and entitled to vote is wholly owned by Filipinos; or a trustee of funds for pension or other employee retirement or separation benefits, where the trustee is a Philippine national and at least sixty percent (60%) of the fund will accrue to the benefit of Philippine nationals; Provided, That where a corporation and its non-Filipino stockholders own stocks in a Securities and Exchange Commission (SEC) registered enterprise, at least sixty percent (60%) of the capital stock outstanding and entitled to vote of both corporations must be owned and held by citizens of the Philippines and at least sixty percent (60%) of the members of the Board of Directors of both corporations must be citizens of the Philippines, in order that the corporation shall be considered a Philippine national. **The control test shall be applied for this purpose.** (Underlining supplied.)

2 SEC Opinion No. 07-17 dated September 27, 2007 addressed to Mr. Reynaldo G. David.

It shall be understood that the foregoing opinion is rendered based solely on the facts and circumstances disclosed in the query and relevant solely to the particular issue raised therein and shall not be used in the nature of a standing rule binding upon the Commission in other cases whether of similar or dissimilar circumstances. If upon investigation, it will be disclosed that the facts relied upon are different, this opinion shall be rendered null and void.

VERNETTE G. UMALI-PACO
General Counsel

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